# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1927

---

## No. 341

## D. B. HEINER, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE TWENTY-THIRD DISTRICT OF PENNSYLVANIA, PETITIONER

vs.

## JAMES R. TINDLE AND THE UNION TRUST COMPANY OF PITTSBURGH, CO-EXECUTORS, ETC.

---

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

---

INDEX


| | Original | Print |
|---|---|---|
| Record from District Court United States, western Pennsylvania | 1 | 1 |
| Docket entries | 1 | 1 |
| Praecipe and statement of claim | 3 | 2 |
| Exhibit "A." Copy of claim for refund | 13 | 7 |
| Statement of reasons for refund | 15 | 8 |
| Copy of field agent's report | 19 | 10 |
| Affidavit of defense | 25 | 13 |
| Opinion, Thomson, J. | 29 | 15 |
| Plaintiff's request for findings of fact and conclusions of law | 35 | 18 |
| Order adopting findings of fact and rejecting conclusions of law | 42 | 23 |
| Judgment | 43 | 23 |
| Assignments of error | 44 | 24 |
| Stipulation re transcript of record | 47 | 25 |
| Clerk's certificate [omitted in printing] | 47 | 25 |
| Proceedings in United States Circuit Court of Appeals, Third Circuit | 48 | 25 |
| Argument and submission [omitted in printing] | 48 | 25 |
| Opinion, Buffington, J. | 49 | 26 |
| Judgment | 52 | 28 |
| Mandate | 53 | 28 |
| Clerk's certificate [omitted in printing] | 55 | 29 |
| Order allowing certiorari | 56 | 29 |

1 In United States District Court for the Western District of Pennsylvania

JAMES R. TINDLE AND THE UNION TRUST COMPANY OF Pittsburgh, co-executors of the last will and testament of Philander C. Knox, deceased, plaintiffs
v.
D. B. HEINER, COLLECTOR OF UNITED STATES INTERNAL Revenue for the 23rd District of Pennsylvania, defendant
} Law No. 3432

*Docket entries*

Jan. 22, 1926. Praecipe for summons in assumpsit and statement of claim filed.

Jan. 22, 1926. Summons in assumpsit issued returnable 1st Mon. of Feb. next.

Jan. 29, 1926. Summons returned served on D. B. Heiner, collector of internal revenue, 23rd Dist. Pa., by handing to and leaving
2 a true and attested copy thereof with D. B. Heiner, personally at Pittsburgh, Jan. 23, 1926.

Feb. 2, 1926. Praecipe for appearance of John D. Meyer and W. J. Aiken for deft.

Feb. 25, 1926. Affidavit of defense filed.

Mar. 10, 1926. Stipulation waiving jury trial filed.

Mar. 10, 1926. Trial without a jury had; C. A. V.

Mar. 10, 1926. Witnesses sworn for plff. (4).

Mar. 10, 1926. Motion of W. J. Aiken, for the court to render judgment for the defendant filed.

Mar. 10, 1926. Trial mem. filed.

Nov. 23, 1926. Opinion entitling plaintiff to judgment in sum of $4,863.04 with interest from February 2, 1925, and judgment entered accordingly, filed, and entered.

Jan. 21, 1927. Stipulation filed, agreeing that judgment of $4,863.04 hereinbefore entered in favor of plaintiff, be vacated.

Jan. 21, 1927. Order of court filed and entered vacating the judgment entered on Nov. 23, 1926, and entering judgment in favor of the defendant with costs.

Jan. 21, 1927. Request for findings of fact and conclusions of law and the action of the court with reference thereto.

Jan. 25, 1927. Assignments of error filed.

Jan. 25, 1927. Petition for writ of error filed.

Jan. 25, 1927. Order of court filed and entered allowing writ of error and fixing the bond for costs at the sum of $200.

Jan. 25, 1927. Citation with acceptance of service by W. J. Aiken issued.

3 Jan. 25, 1927. Stipulation for printing record filed.

Jan. 25, 1927. Writ or error allowed.

Jan. 27, 1927. Bond on appeal approved & filed.

Certified from the records this 28th day of January, 1927.

[SEAL.] J. WOOD CLARK, *Clerk.*

In United States District Court

*Praecipe and statement of claim*

(Filed January 22, 1926)

PRAECIPE

To J. WOOD CLARK, *Clerk:*
Issue summons in assumpsit returnable next return day.

JAMES WALTON,
*Attorney for Plaintiffs.*

STATEMENT OF CLAIM

James R. Tindle and The Union Trust Company of Pittsburgh, plaintiffs above named, bring this suit against D. B. Heiner, collector of United States internal revenue for the twenty-third district of Pennsylvania at Pittsburgh, to recover the sum of twenty thousand three hundred fifty-six and 85/100 ($20,356.85) dollars, with interests and costs upon a cause of action whereof the following is a statement:

I

Philander C. Knox died October 12th, 1921. At the time of his death he was a citizen of Pennsylvania and a resident of Pitts-
4 burgh, Allegheny County, in the western district of said State. His last will and testament was duly admitted to probate in the Orphans' Court of Allegheny County and, on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff, James R. Tindle, is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said State, and the plaintiff, The Union Trust Company of Pittsburgh, is a Pennsylvania corporation, with its principal office and place of business at Pittsburgh, Allegheny County, Pennsylvania. By its articles of incorporation, The Union Trust Company of Pittsburgh is authorized and empowered to act as executor, trustee, and in other fiduciary capacities.

II

The defendant, D. B. Heiner, is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the western district of Pennsylvania. Said Heiner, at the time of the grievance herein complained of and at the date of filing the complaint, is collector of United States internal revenue for the twenty-third district of Pennsylvania, which district comprises within its borders the county of Allegheny.

III

Within the time prescribed by law, the said Philander C. Knox, pursuant to the provisions of the act of Congress approved February 24, 1919, entitled "An act to provide revenue, to defray war expenses and for other purposes" (commonly known as the revenue act of 1918), duly made and filed his income tax return for the calendar year 1920 on Form 1040, which is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV

In his said tax return taxpayer claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

| | | |
|---|---|---|
| March 1st, 1913, fair value | | $120,000.00 |
| Depreciation sustained | $3,000.00 | |
| Selling price | 70,000.00 | |
| | | 73,000.00 |
| Loss | | $47,000.00 |

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214 (a) 5, of the said revenue act of 1918, which reads:

"That in computing net income there shall be allowed as deductions—

* * * * * * *

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

6 V

The facts with reference to the said transaction are that in the years 1887–1888 former United States Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish; however, the United States revenue field agent

who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established by A. & S. Wilson Company, one of the oldest firms of contractors in Pittsburgh. They show a cost appraisal of the residence as of the date of construction in the aggregate amount of $119,458.00. Similarly, with respect to the stable, they show the reproductive cost as of the date of construction to be $10,226.00.

About the year 1901, the Senator having been elected to the United States Senate, he leased the entire property to Mr. W. E. Corey, former president of the United States Steel Corporation, for a
7 period of 3½ years, the lease being dated October 1st, 1901, and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having a duration of ten years and providing for an annual rental of sixty-five hundred ($6,500.00) dollars. This lease was followed by a third lease dated April 1st, 1915, having a duration of one year for a stated annual rental of six thousand ($6,000.00) dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

As a part of the transaction Hammett was required to turn over to the Senator the equivalent of $9,500.00 advance rental collected by him on a garage property, which garage property represented part consideration in the transaction. The field agent held that such sum constituted additional income to the Senator and made adjustment accordingly (page 3 of his report).

8 The field agent made a comptation of his own of the consideration received by the Senator, taking into consideration accrued taxes, interest, etc., and arrived at the amount of $64,206.79 (page 3 of his report). For the purpose of this suit, it is admitted that the consideration as found by the field agent is correct, provided that there be added thereto the $9,500.00 hereabove mentioned.

## VI

Thereafter, as the result of the examination of plaintiffs' tax liability by the said United States Field Agent J. B. Harmon, plaintiffs were advised of a proposal to assess an alleged additional tax in the

sum of $19,659.73. The said field agent, as pretended justification for the imposition of the proposed additional tax, asserted that taxable income shall be increased $56,500.00 In his official report, of which plaintiffs have been given a copy, he makes the following explanation:

"In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92 be increased by the following:

| | | |
|---|---|---|
| Disallowance of loss on sale of former residence | $47,000.00 | |
| Rent for the year 1921 received in 1920 | 9,500.00 | |
| | | 56,500.00 |
| Corrected net income | | $94,156.92" |

9

VII

Thereafter, under date of September 27th, 1924, symbols IT: PA-5, CTN-505, the Commissioner of Internal Revenue advised plaintiffs that the conclusions of the field agent had been confirmed and that there was due from plaintiffs a pretended deficiency in tax of the aforesaid sum of $19,659.73.

VIII

Thereafter, on or about January 23rd, 1925, the defendant, as collector of United States internal revenue, demanded payment of the said sum of $19,659.73 alleged additional income tax from plaintiffs. Said amount was paid by plaintiffs to defendant on February 2nd, 1925, and such payment was made under protest and under duress, such duress consisting of threats by said defendant Heiner to impose penalties, levy distraint, and seize plaintiffs' property.

IX

Thereafter, on June 1st, 1925, plaintiffs duly filed with the defendant as collector of internal revenue for the twenty-third Pennsylvania district at Pittsburgh, on Form 843, the form prescribed by the Treasury Department, a claim for refund of the said amount of $19,659.73. A copy of said claim is attached hereto, designated "Exhibit A." There is imprinted thereon these words, as follows—

"Important.—File with the collector of internal revenue where assessment was made."

10

X

The said claim for refund was rejected by the Commissioner of Internal Revenue on August 20th, 1925, for the alleged reason that the loss claimed arose in a transaction not entered into for profit. At the time of filing this complaint, the said sum of $19,659.73 has not been refunded nor has any part thereof.

## XI

Plaintiff avers that there existed no warrant in fact or in law for the disallowance and exclusion by the aforesaid taxing authorities of said $47,000.00 loss suffered on the sale of said property as a deduction in the computation of taxable income, upon the alleged theory that loss arose from a transaction not entered into for profit,—

(2), nor for the imposition and collection of $19,659.73 alleged additional tax as a consequence thereof—

(3), nor for assuming that the selling price of the property was less than its cost; when, as a matter of truth and fact, the cost of the property was not less than $172,401.00—

(4), nor for assuming that the fair market value of the property at March 1st, 1913, was not in excess of $65,000.00; when, as a matter of truth and fact, the fair market value of the property at said date was not less than $125,000.00—

(5), nor for assuming that $9,500.00 received by taxpayer was taxable income because taxpayer's grantee had collected a like
11 amount as advanced rental when, as a matter of truth and fact, such sum was part of the consideration received for the sale.

## XII

Plaintiffs further aver that the amount of loss correctly and properly deductible in the computation of the tax liability is—

| | | |
|---|---|---|
| Fair market value of property at March 1st, 1913 | | $125,000.00 |
| Consideration received: | | |
| As computed by field agent | $64,206.79 | |
| Additional consideration | 9,500.00 | |
| | | 73,706.79 |
| Deductible loss | | 51,293.21 |

## XIII

When the true and correct amount of the deductible loss from the aforesaid sale, to wit, the said sum of $51,293.21, is employed, the amount of tax properly refundable is shown to be $20,356.85, all of which is set forth in the following computation:

| | | |
|---|---|---|
| Taxable income employed by field agent and adopted by commissioner | | $94,156.92 |
| Amount of loss deductible | $51,293.21 | |
| Amount erroneously added to income as rent | 9,500.00 | |
| | | 60,793.21 |
| Correct taxable income | | 33,363.71 |
| 12 Tax previously paid: | | |
| Paragraph III, *supra* | $2,991.68 | |
| Paragraph VIII, *supra* | 19,659.73 | |
| | | $22,651.41 |
| Tax on $33,363.71 | | 2,394.56 |
| Amount refundable | | $20,356.85 |

## XIV

Under sections 1019 and 1020 of the revenue act of 1924, plaintiffs may be allowed interest at the rate of six per centum per annum on the said sum of $20,356.85, from the date of payment thereof, to wit, from February 2nd, 1925.

## XV

This is a suit of a civil nature at common law and the matter in controversy, exclusive of interest, exceeds the sum of $3,000.00. The cause of action herein set forth arises under the laws of the United States for the assessment and collection of internal revenue.

Wherefore, plaintiffs pray judgment of the defendant in the sum of twenty thousand, three hundred fifty-six and 85/100 ($20,356.85) dollars with interest, together with the costs of this suit.

JAMES WALTON,
*Attorney for Plaintiffs.*

13 *Duly sworn to by Charles E. Young. Jurat omitted in printing.*

## EXHIBIT A

(Copy of claim for refund)

(Execute separate form for each tax period)

*Claim for refund of taxes illegally collected*

STATE OF PENNSYLVANIA,
*County of Allegheny, ss:*

Estate of Philander C. Knox, deceased, c/o Union Trust Company, executor, Pittsburgh, Pa.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer
14 named, and that the facts given below with reference to said statement are true and complete:

1. Business in which engaged. Individual.
2. Character of assessment or tax. 1920 income.
3. Amount of assessment or stamps purchased (alleged additional), $19,659.73.
4. Reduction of tax liability requested (income and profits tax). Not applicable.
5. Amount to be abated. Not applicable.
6. Amount to be refunded (or such greater amount as is legally refundable), $19,659.73.
7. Dates of payment (see collector's receipts or indorsements of canceled checks). February 2nd, 1925.

8. District in which return (if any) was filed. 23rd Penna., Pittsburgh.

9. District in which unpaid assessment appears. Not applicable.

10. Amount of overpayment claimed as credit. Not applicable.

11. Unpaid assessment against which credit is asked; period from. Not applicable.

Deponent verily believes that this application should be allowed for the following reasons:

Taxpayer attaches hereto a full and complete statement of the reasons why refund in the above-stated amount should be made. Such statement, together with the exhibits attached thereto are hereby referred to and specifically made a part of this claim for refund.

Address of taxpayer's attorney: James Walton, Southern Building, Washington, D. C.

THE UNION TRUST COMPANY OF PITTSBURGH,
By (Signed) CHARLES E. YOUNG,
*Co-Executor, Asst. Trust Officer.*

Sworn to and subscribed before me this 1st day of June, 1925.
(Signed) JESSIE A. ROBERTSON,
*Notary Public.*

In the matter of Philander C. Knox, deceased, Union Trust Company, executor, Pittsburgh, Penna. 1920 income tax

*Taxpayer's statement of the reasons why refund must be made*

## I

A report of examination by Field Agent J. B. Harmon of the Pittsburgh revenue office, a copy of which was delivered to the executor on January 21st, 1924, advises taxpayer of a proposal to assess him with an additional tax in the amount of $19,659.73. A copy of this field agent's report is attached hereto as Exhibit A and the essential part thereof with reference to this particular matter reads as follows:

"In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92, be increased by the following:

| | | |
|---|---|---|
| Disallowance of loss on sale of former residence | $47,000.00 | |
| Rent for the year 1921 received in 1920 | 9,500.00 | 56,500.00 |
| Corrected net income | | $94,156.92" |

II

Thereafter the Commissioner of Internal Revenue at Washington, D. C., under date of July 24th, 1924, symbols IT:PA:5 CTN–505, duly advised the taxpayer of a proposal to assess an alleged deficiency in tax amounting to $19,659.73. This letter was on the usual Form NP–1, and the essential part of it reads:

"Additional tax, $19,659.73

"1920

"Verification of the books of account and records of Philander C. Knox as shown by the supplemental report of the revenue agent dated March 29, 1924, has been approved.

"You are advised that the action taken by the revenue agent in regard to the disallowance of the loss on the sale of his residence has been sustained."

17

III

Thereafter, on or about January 23rd, 1925, the collector of internal revenue at Pittsburgh, Pa., made due demand for the payment of the aforesaid sum of $19,659.73, which amount was paid by the executor of the deceased taxpayer on February 2nd, 1925, all of which appears from the collector's receipt, a copy of which reads:

Receipt for payment of taxes. Original. Addl. income tax

Collector's office, 23rd district of Penna., at Pittsburgh, Pa. Date 2/2/25. Check; year 1920

Name and address of taxpayer: Philander C. Knox, deceased % Union Trust Co., executor, Pittsburgh, Pa.

Amount $19,659.73. 1924 addl.

Jan. 186 P.

Paid Feb. 2, 1925. Int. rev. col. office, 23rd district, Pgh., Pa.

IV

Taxpayer respectfully shows that the field agent erred, that the commissioner's office erred in adopting the conclusions of the field agent, and that the action of the collector of internal revenue at Pittsburgh in insisting upon the payment of the alleged

18 additional tax was incorrect, not in accordance with the facts, and contrary to law, in the following particulars:

(1) In assuming that the selling price of the property was less than its cost; whereas, as a matter of truth and fact, the cost of the property, the loss upon the sale of which is proposed to be disallowed, was not less than $124,206.79.

(2) In assuming that the market price of the property at March 1st, 1913, was not in excess of $65,000.00; whereas, as a matter of

truth and fact, the market value of the property at said date was not less than $120,000.00.

(3) In presuming to add and include as taxable income an amount of $9,500.00 paid to the taxpayer by the purchaser of the property, which $9,500.00 represented advance rent collected by said purchaser on property which he traded to the taxpayer as part consideration for the taxpayer's property. As a matter of fact and law, this $9,500.00 was income of the taxpayer's grantee when received by him and is not, in any sense, taxable income to your petitioner; notwithstanding all of which the field agent has so computed it and his computation has been tentatively approved by the office of the Commissioner of Internal Revenue.

It thus appearing that the field agent's proposed increase of taxable income is erroneous, it necessarily follows that the alleged additional income tax required to be paid thereon was not lawfully due and that the amount thereof should be refunded.

19 EXHIBIT A

*Copy of field agent's report*

(Dated January 18, 1924)

In the matter of Philander C. Knox, deceased, Union Trust Company, executor, Pittsburgh, Penna. 1920 income tax

* * * * * * *

Note: If conference is desired, please arrange for an appointment. Mail to 802 Chamber of Commerce Bldg. Phone Smithfield 2438.

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
OFFICE OF INTERNAL REVENUE AGENT,
IN CHARGE PITTSBURGH DIVISION,
*January 18, 1924.*

In re: P. C. Knox, % Union Trust Company, executor, Pittsburgh, Pa. Date of report: January 11, 1924. Year examined: 1920

SIRS: There is transmitted herewith copy of report covering examination recently made by a representative of this office concerning your income-tax liability.

No remittance should be made until you receive notice of assessment from the collector of internal revenue for your district.

20 It is desired that every opportunity be afforded you to present any objections or any additional information which you believe might affect the result of the final decision of the Commissioner of Internal Revenue at Washington, D. C. The original of this report will therefore be held in this office for a period not to exceed twenty days from the date of this letter in order that you

may, if you so desire, present any protests, briefs, or letters should be forwarded in duplicate to this office. These papers will receive consideration before the report with all papers pertaining to the same is transmitted to Washington for final action by the Commissioner of Internal Revenue. If you agree to the findings of the examining officer, the report will be forwarded to the department at once.

Please acknowledge receipt by return mail, indicating whether protest will be submitted.

Respectfully,

ALBERT W. SMITH,
*Internal Revenue Agent in Charge.*

In re: P. C. Knox, % Union Trust Company, executor, Pittsburgh, Pa. January 11, 1924

Examining officer, J. B. Harmon.
Examination commenced December 20. Suspended.
Examination completed January 11; 7½ days.
Internal revenue agent in charge, Pittsburgh, Pa.

21 An investigation of records in connection with the income-tax liability of the above-named individual for the calendar year 1920 discloses the following:

*Summary*

| Year | Form | Additional tax |
|---|---|---|
| 1920 | 1040 | $19,659.73 |

Authority for examination: Photostat copy of 1920 return, which is attached hereto.

Lack of records in this district prevented a thorough examination, although it is extremely doubtful that sufficient records could be assembled for such an examination of this case.

Your examiner has delved into all the available records in this city and has made quite a thorough examination of the sale of taxpayer's former residence reported in his 1920 return.

Marital exemption: Married, living with wife.

Wife's income: Separate return, with no claim for exemption.

The valuation placed by the city of Pittsburgh on the former residence property of the taxpayer for the year 1913 and subsequent years, including the year 1920, was as follows:

| | |
|---|---|
| Land | $72,630.00 |
| 2 story stone brick dwelling | 40,000.00 |
| Frame stable | 3,000.00 |
| Total | $115,630.00 |

Your examiner finds upon investigation that the land included in the above cost the taxpayer $16,400.00 in three lots bought in
22 1886, 1887, and 1892. The cost to the taxpayer for the erection of the buildings was probably $50,000.00 or more.

The real estate agent who sold the taxpayer's former residence property stated that the price at which it was sold, $65,000.00, was the market value of the property at March 1, 1913, and that a greater price could not be obtained for it at that date. The distribution of value at March 1, 1913, would probably be land, $40,000.00; dwelling, $24,000.00; and stable, $1,000.00.

In the sale of his property, the taxpayer took in payment a $90,000.00 property and assumed a mortgage of $40,000.00 on same, leaving him an equity of $50,000.00, which is confirmed by $50.00 of revenue stamps of deed received, and in addition, he received $15,000.00 cash. The former owner of the $90,000.00 property had received $9,500.00 in advance for rent of the large garage building on his property for the year 1921. This rent he had to turn over to the taxpayer at the time of closing the sale in November of 1920. The taxpayer apparently thought he had included this advance rent in the reported selling price of his property at $70,000.00, but investigation of the records of the real estate agent who sold the property for him discloses the fact that he received the following in settlement for the sale:

| | | |
|---|---|---|
| Equity in new property | $50,000.00 | |
| Cash | 15,000.00 | |
| Accrued interest on $40,000.00 mortgage from 6/12/20 to 11/15/20 | 1,020.00 | |
| 23 Pro rata amount of 1920 city and county taxes on his former residence property | 404.40 | |
| | | $66,424.40 |
| Less pro rata amount of 1920 city and county taxes on property taken in payment | 152.61 | |
| Revenue stamps on deed given | 65.00 | |
| Commission for selling | 2,000.00 | |
| | | 2,217.61 |
| Net proceeds or selling price | | 64,206.79 |

Depreciation from March 1, 1913, to Dec. 31, 1919, is as follows:

| | |
|---|---|
| Brick stone dwelling— | |
| $24,000.00 at 2% equals | $480.00 per yr. |
| Frame stable— | |
| $1,000.00 at 5% equals | 50.00 per yr. |
| Total | 530.00 per yr. |

$530.00 per year for 6⅞ yrs. equals $3,621.67.

In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92, be increased by the following:

| | | | |
|---|---|---|---|
| 24 | Disallowance of loss on sale of former residence | $47,000.00 | |
| | Rent for year 1921 received in 1920 | 9,500.00 | |
| | | | $56,500.00 |
| | Corrected net income | | 94,156.92 |
| | Dividends | 66,544.00 | |
| | Personal exemption | 2,000.00 | |
| | | | 68,544.00 |
| | Amount subject to normal tax | | 25,612.92 |
| | Amount subject to normal tax of 4% | | 4,000.00 |
| | Amount subject to normal tax of 8% | | 21,612.92 |
| | Normal tax at 4% | 160.00 | |
| | Normal tax at 8% | 1,729.03 | |
| | Surtax per schedule | 20,762.18 | |
| | Total tax | 22,651.21 | |
| | Previously assessed | 2,991.48 | |
| | Additional tax | 19,659.73 | |

The Union Trust Co. of Pittsburgh, Pa., one of the executors of the now deceased taxpayer, has been advised of the findings of this examination and has protected it in a letter to be mailed in to this office.

(Signed) J. B. HARMON,
*Internal Revenue Inspector.*

25 *To the within defendant:*

You are required to file an affidavit of defense to this statement of claim within 15 days from the service hereof.

JAMES WALTON,
*Attorney for Plaintiffs.*

Fulton Building, Pittsburgh, Penna.

In United States District Court

*Affidavit of defense*

(Filed February 25, 1926)

STATE of PENNSYLVANIA,
*County of Allegheny, ss:*

D. B. Heiner, being duly sworn according to law, declares and says that he is the defendant in the above entitled cause and that he has a just, true, complete, and legal defense to the whole of plaintiff's claim of the character and nature as follows:

1. The averments of paragraph 1 of plaintiffs' statement of claim are admitted.

2. The averments of paragraph 2 of plaintiffs' statement of claim are admitted.

3. The averments of paragraph 3 of plaintiffs' statement of claim are admitted.

4. The averments of paragraph 4 of plaintiffs' statement of claim are admitted.

5. The averments of paragraph 5 of plaintiffs' statement of claim are admitted.

6. The averments of paragraph 6 of plaintiffs' statement of claim are admitted.

26 7. The averments of paragraph 7 of plaintiffs' statement of claim are admitted.

8. The averments of paragraph 8 of plaintiffs' statement of claim are admitted.

9. The averments of paragraph 9 of plaintiffs' statement of claim are admitted.

10. The averments of paragraph 10 of plaintiffs' statement of claim are admitted but in mitigation thereof the defendant avers that on or about January 25, 1926, the said claim for refund was allowed in the sum of $4,863.04 and that the plaintiff, the Union Trust Company of Pittsburgh, executor, etc., was notified of such allowance by letter from C. R. Nash, assistant to the commissioner, dated January 25, 1926, of which a copy was sent to Mr. J. M. Cumming, Southern Building, Washington, D. C., of counsel for the plaintiffs and so expects to be able to prove at the trial of this case.

11. The averments of paragraph 11 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the revenue act of 1918 there was no deductible loss suffered on the sale of said property; (2) that the said law justified the imposition and collection of the tax of $19,659.73, less the overassessment of $4,863.04, as above set out; (3) that there has been no assumption that the selling price of the property was not less than its cost; (4) that the fair market value of its property on March 1, 1913, in the claim for refund filed by the plaintiffs is stated at not less than $120,000, while in the complaint herein filed the same value of this property is stated at not less than $125,000; (5) that the contention of

27 the taxpayer in regard to the $9,500 has been conceded and this amount is the principal basis of the refund of $4,863.04 as above set out, all of which defendant expects to be able to prove at the trial of this case.

12. The averments of paragraph 12 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the revenue act of 1918 and regulations promulgated pursuant to law, no loss was suffered from the sale of this property, and so expects to be able to prove at the trial of this case.

13. The averments of paragraph 13 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the provisions of the revenue act of 1918 and regulations promulgated in pursuance to law, there was no deductible loss for income tax purposes from the sale of this property, and that the only sum refundable to the plaintiffs herein is the sum of $4,863.04, which was made the subject of certificate of overassessment No. 877468 and of which plaintiffs were advised on January 25, 1926, the said amount being arrived at as follows:

| | |
|---|---|
| Tax assessed (original tax) | $2,991.68 |
| Additional assessment, January, 1925, list, page 13, line 6 | 19,659.73 |
| Total assessment | 22,651.41 |
| Tax liability | 17,788.37 |
| Overassessment | 4,863.04 |

and so expects to be able to prove at the trial of this case.

28 14. The averments of paragraph 14 of plaintiffs' statement of claim are denied in so far as it is alleged that interest may be allowed at the rate of 6% per annum on said sum of $20,356.85, and in answer thereto the defendant avers that the plaintiffs are entitled to interest at the rate of 6% per annum upon any amount recovered in this action, but that the amount so recovered, if any, cannot exceed the sum of $19,659.73, less $4,863.04 heretofore allowed plaintiff as above set out—that is, $14,796.69—and so expects to be able to prove at the trial of this case.

15. The averments of paragraph 15 of plaintiffs' statement of claim are admitted.

I, therefore, owe the plaintiff nothing.

All of the above stated facts are correct and true and defendant avers and expects on the trial of this case to be able to prove the same.

D. B. HEINER.

Subscribed and sworn to before me this 24th day of February, 1926.

GERTRUDE HORTON BERGER,
[SEAL.] *Dep. Clerk U. S. Dist. Court.*

29 In United States District Court

*Opinion*

(Filed Nov. 23, 1926)

THOMSON, J.: This is an action brought by the executors of the will of Philander C. Knox, deceased, against the collector of internal revenue of this district, to recover additional tax for the year 1920, the amount of which was assessed by the Government, and paid by the decedent under protest.

The facts in the case are briefly these: Senator Knox, decedent, built, in about the year 1887, a residence in the city of Pittsburgh, at a cost of approximately $172,000.00. The building was occupied by Mr. Knox as his residence from the time it was built until 1901, when he was elected to the United States Senate. At that time the Senator moved his residence to the Schenley Hotel, Pittsburgh, from which residence he voted until the time of his death in 1921. From 1901 until 1920 he leased the property to various tenants, and in 1920 sold it to one James H. Hammett for the sum of $73,706.79.

The plaintiffs contend that the property was worth in the neighborhood of $120,000.00 on March 1, 1913, and claim as a loss the difference between that sum and the amount for which it was sold in 1920, and seek to deduct that amount from the income of the taxpayer for the year 1920 under section 214 (a) (5) of the revenue act of 1918. This particular section of the law reads as follows:

"That in computing net income there shall be allowed as deductions:

30 "5. Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business."

The defendant's contention is that the purchase of the property by a taxpayer for his residence is not a transaction entered into for profit under the revenue acts. He also contends that the property had the same value in 1913 that it had in 1920, at the time of its sale, and that hence no deductible loss in any case was sustained by the taxpayer.

The evidence justifies the finding which I now make, that the fair value of the property as of March 1, 1913, was $120,000.00, and if the loss in the sale is a deductible loss under the section of the revenue act above recited, the difference between that value and the price at which the property sold would represent that loss. We are, therefore, confronted with the question of the proper interpretation of the law in question under the facts as they are conceded to be. The provisions of section 5 are also contained in the revenue acts of 1921, 1924, and 1926. Regulations 45 as promulgated April 17, 1919, provided as follows:

"Art. 141. Losses. * * * A loss in the sale of an individual's residence is not deductible."

This regulation was amended on January 28, 1921, to read as follows:

"Art. 141. Losses. * * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

31 This same provision is contained in regulations 62, under the revenue act of 1921, and in regulations 65, under the revenue act of 1924.

The question is, Is the purchase of property by a taxpayer for his residence a transaction entered into for profit; if not, where the taxpayer ceases to use the property as his residence and leases it to another as a residence, is the status changed, making the renting of the property a new transaction entered into for profit?

In the Solicitor's Law Opinion 780 (1 Cumulative Bulletin 117) it is said:

"The expression 'transaction entered into for profit' clearly means a complete business venture from inception to conclusion. The de-

duction allowed is for losses sustained in any transaction 'entered into' for profit. The intent to make a profit must have existed at the commencement of the enterprise or the right to deduct losses incurred is not within the contemplation of the statute. To construe the words 'transaction entered into for profit' as referring only to the conclusion of the venture—that is, the sale of the property—would result in a practical nullification of the statute. * * *

"Where a loss incurred in the sale of residential property is deductible in arriving at net income must be determined by the object or intent of the individual in buying or constructing the property."

The provision of the law under which the plaintiff claims
32 was not in any revenue act prior to 1918, but has been in all the revenue acts from 1918 to and including the act of 1926. Except in one appeal before the Board of Tax Appeals no case is reported in the courts interpreting this provision. In the case of the appeal of John J. Madden, 2 U. S., Board of Tax Appeals, page 702, decided on September 30, 1925, the board held that the building of a house to meet the taxpayer's requirements for a home was not a transaction entered into for profit. In office decision 1148 (5 Cumulative Bulletin, page 141) it is said:

"It is held that if a loss is deductible at all it is deductible under section 214 (a) 5 of the revenue act of 1918 as a loss sustained in a transaction entered into for profit. However, the mere renting of property purchased without the intention at the time of purchase of making a pecuniary profit thereon does not constitute a 'transaction entered into for profit' within the meaning of the statute, and as the taxpayer in the instant case purchased the property for a home, it was not his intention at the time to subsequently sell it for profit. It is therefore held that any loss sustained is not deductible for the purposes of the revenue act of 1918."

Ever since the act of 1918 was passed the regulations have provided that a loss in the sale of property purchased by a taxpayer for his residence is not a loss in a transaction entered into for profit. The original regulations 45 provided that a loss in the sale of an individual's residence is not deductible. The amendment of
33 January 28, 1921, provided that a loss on the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. The one is an amendment of the other and can scarcely be said to have effected any material change. Both relate to the beginning of the transaction, viz, the purchase or construction of the property in question.

The decisions of the department have been uniform and all have held the loss in such cases not a deductible loss. The reinactment of the law year after year without change must be taken as an indication not only to continue in force the existing law but to adopt the practice of the department in interpreting and applying it. It was said in United States *v.* Anderson, 46 Sup. Ct., 131:

"By thus adopting without material change, the corresponding provisions of earlier acts, Congress might have been deemed to have recognized and adopted the established practice of the department interpreting and applying them. National Lead Co. *v.* United States, 252 U. S., 140."

See also Provost *v.* United States, 46 Sup. Ct., 152.

The issuing of regulations by the Secretary of the Treasury is subsequently made his duty by the revenue act of 1918, and other revenue acts, and the Supreme Court has held that it is settled by the decisions of that court that a regulation by a department of Government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is
34 confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. United States *v.* Grimaud, 220 U. S. 506, and many other cases.

It appears to me that the rulings of the department are in harmony with the provisions of the law. The transaction in question is one which began with the purchase and ended with the sale. The transaction was the ownership of the property and was ended when the property was sold. It cannot be fairly said that this was entered into for profit but was entered into for the purpose of providing a home for the taxpayer. The transaction which was begun by the leasing of the property ended when the lease was ended, and it is not suggested that this was a loss. This is true of each succeeding lease. The transaction which was ended by the sale of the property seems clearly to have been the one which was begun by its purchase.

I am, therefore, compelled to hold that the plaintiffs' position that the loss claimed by the decedent as a deduction from taxable income under section 214 (a) of the revenue act of 1918, cannot be sustained. It appears, however, that in June, 1925, the plaintiffs filed with the defendant as collector of internal revenue, a claim for refund of the amount of taxes which had been paid under protest, which claim was denied except as to the amount of $4,863.04, which sum was allowed, but has not in fact been paid by the Government. The allowance of this claim is conceded by the defendant in the affidavit of defense filed.

35 Plaintiff is, therefore, entitled to judgment in this action in the sum of $4,863.04 with interest from the date of payment thereof, to wit, from February 2, 1925.

Judgment may, therefore, be entered accordingly.

In United States district court

*Plaintiff's request for findings of fact, conclusions of law, and order of court*

(Filed January 21, 1927)

Comes now the plaintiff, by James Walton, Esquire, its counsel, and, in accordance with rule 38 of the United States Supreme Court

as revised, paragraph 2, adopted June 8, 1925, and effective July 1, 1925, considering itself aggrieved by the findings of fact and conclusions of law as made and handed down by the honorable court in the above-entitled cause on the 23rd day of November, 1926, and considering the facts hereafter set forth to have been proven and deeming them material to a hearing and determination of this cause upon a writ of error to the Circuit Court of Appeals and similarly so considering with respect to the conclusions of law hereafter set forth, does, therefore, respectfully request the honorable court to find as facts and as conclusions of law as follows:

FINDINGS OF FACT

I

Philander C. Knox died October 12th, 1921. At the time of
36 his death he was a citizens of Pennsylvania and a resident of Pittsburgh, Allegheny County, in the western district of said State. His last will and testament was duly admitted to probate in the Orphans Court of Allegheny County, and on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff James R. Tindle is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said State, and the plaintiff The Union Trust Company of Pittsburgh is a Pennsylvania corporation with its principal office and place of business at Pittsburgh, Allegheny County, Pennsylvania. By its articles of incorporation, the Union Trust Company of Pittsburgh is authorized and empowdered to act as executor, trustee, and in other fiduciary capacities.

II

The defendant D. B. Heiner is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the western district of Pennsylvania. Said Heiner, at the time of the grievances set forth in and at the date of filing the statement of claim is collector of United States internal revenue for the twenty-third district of Pennsylvania, which district comprises within its borders the county of Allegheny.

III

Within the time prescribed by law, the said Philander C. Knox,
37 duly made and filed his income tax return for the calendar year 1920 on Form 1040, which is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV

In his said tax return Mr. Knox claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

| | | |
|---|---|---|
| March 1st, 1913, fair value | | $120,000.00 |
| Depreciation sustained | $3,000.00 | |
| Selling price | 70,000.00 | |
| | | 73,000.00 |
| Loss | | $47,000.00 |

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214 (a), 5, of the revenue act of 1918, which reads—

"That in computing net income there shall be allowed as deductions—

* * * * * * *

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

V

38 The facts with reference to the said transaction are that in the years 1887–1888 former United States Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish; however, the United States revenue field agent who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established as of the date of construction to be the sum of $119,458.00. Similarly, with respect to the stable, the cost as of the date of construction is fixed at $10,226.00.

About the year 1901 the Senator, having been elected to the United States Senate, leased the entire property to Mr. W. E. Corey, former president of the Unit'd States Steel Corporation, for a period of 3½ years, the lease being dated October 1st, 1901, and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having

a duration of ten years and providing for an annual rental of sixty-
five hundred ($6,500.00) dollars. This lease was followed by
39 a third lease dated April 1st, 1915, having a duration of one
year for a stated annual rental of six thousand ($6,000.00)
dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

VI

I find as a fact that the cost of the entire property was approximately $172,000.00.

VII

I find as a fact that the March 1, 1913, fair market value of the entire property was $120,000.00.

VIII

I find as a fact that the total consideration which Mr. Knox received for the entire property was $73,706.79.

40 IX

The Commissioner of Internal Revenue, in auditing Senator Knox's tax return, made two changes or adjustments:

First, he disallowed the $47,000.00 claimed loss on the sale of the property at 5044 Ellsworth Avenue; and,

Second, he added $9,500.00 to income which he claimed was rental.

By this process $19,659.73 alleged additional tax was computed against the taxpayer, it was duly assessed, it was paid under protest, a claim for refund was filed, and the claim for refund was rejected by the Commissioner of Internal Revenue on August 20, 1925. This suit was filed January 22, 1926.

X

The plaintiff's contention with respect to the $9,500.00 item is conceded by the defendant and, subsequent to the date of the trial, a refund was made to the plaintiff to the extent such item was a factor in the alleged additional tax, to wit, $4,863.04.

CONCLUSIONS OF LAW

I

I find, as a conclusion of law, that the leasing of the property in the year 1901 and the then permanent abandonment of same by Senator Knox as his residence terminated what originally may have been a transaction entered into not for profit.

41 II

I find, as a conclusion of law, that the permanent abandonment of the residence by the plaintiff in 1901 and the continuous subsequent leasing of same constituted a new transaction—a transaction entered into for profit, and that the loss suffered in the sale of the property in 1920 is a proper and legal deduction in the ascertainment of taxable income.

III

I find, as a conclusion of law, that the amount of said deduction is the difference between the March 1, 1913, fair market value of the property, to wit, $120,000.00, such sum being less than the cost thereof, and the sum of $73,706.79, the consideration received, or $46,293.21.

IV

I find, as a conclusion of law, that in determining whether a transaction is entered into for profit or not for profit, the status of the property at March 1, 1913, the effective date of the sixteenth amendment to the United States Constitution (known as the income tax amendment) is decisive in making the determination, provided the property represented by the transaction was owned prior thereto.

V

I find, as a conclusion of law, that plaintiff is entitled to a judgment against the defendant in the amount sued for as set
42 forth in the statement of claim, together with costs and statutory interest, subject, however, to adjustment and modification in the amount of $4,863.04 which has already been refunded to the plaintiff and such further adjustment as results from revising or correcting the loss on the sale of the former residence from $47,000.00 to $46,293.21.

Respectfully submitted.

JAMES WALTON,
*Attorney for Plaintiff.*

JANUARY 17, 1927.

## In United States District Court

### *Order of court*

(a) Adopting plaintiff's requested findings of fact.
(b) Rejecting plaintiff's requested conclusions of law.

And now, to wit, on this 21st day of January, 1927, this cause comes before the court upon the plaintiff's request for specific findings of fact and conclusions of law, and the court being fully advised in the premises and having heretofore, on November 23, 1926, handed down its opinion in the case, does therefore find and decline to find as follows:

Each and every one of plaintiff's requested findings of facts, numbered I to X, inclusive, are approved and adopted in their entirety, the same being not inconsistent with the court's opinion heretofore filed.

Each and every one of plaintiff's requested conclusions of
43 law, numbered I to V, inclusive, are disapproved and rejected in their entirety, the same being contrary to the court's opinion heretofore filed.

W. H. S. THOMSON, *Judge.*

Eo die, plaintiff objects to the above action of the court in rejecting his requested conclusions of law and at his instance exception noted.

W. H. S. THOMSON.

## In United States District Court

### *Judgment*

(Filed Jan. 21, 1927)

And now, to wit, January 21, 1927, it appearing by stipulation of counsel herewith filed, that the sum of $4,863.04, the amount conceded to be due plaintiff in the affidavit of defense, was paid by the defendant to the plaintiff prior to the previous entry of judgment herein; by virtue of this fact and under said stipulation, it is hereby ordered and adjudged that the said judgment be, and the same is hereby vacated and set aside. Thereupan counsel for plaintiff presents to the court certain requests for findings of fact and conclusions of law, which requests I have answered and file the same herewith, as if answered and filed with the original opinion; and now, the day and year aforesaid, judgment is hereby entered in favor of the defendant with costs.

W. H. S. THOMSON, *Judge.*

44 In the United States District Court

*Assignments of error*

(Filed Jan. 25, 1927)

The plaintiff in this action, in connection with his petition for a writ of error, makes the following assignments of error which he avers occurred upon trial of the cause, to wit:

I

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered I, as follows:

"I find, as a conclusion of law, that the leasing of the property in the year 1901 and the then permanent abandonment of same by Senator Knox as his residence, terminated what originally may have been a transaction entered into not for profit."

II

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered II, as follows:

"I find, as a conclusion of law that the permanent abandonment of the residence by the plaintiff in 1901 and the continuous subsequent leasing of same, constituted a new transaction,—a transaction entered into for profit and that the loss suffered on the sale of the property in 1920 is a proper and legal deduction in the ascertainment of taxable income."

45 III

The court erred in declining to make and rejecting plaintiffs requ'sted conclusion of law numbered III, as follows:

"I find, as a conclusion of law, that the amount of said deduction is the difference between the March 1, 1913, fair market value of the property, to wit, $120,000.00, such sum being less than the cost thereof, and the sum of $73,706.79, the consideration received, or $46,293.21."

IV

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered IV, as follows:

"I find, as a conclusion of law, that in determining whether a transaction is entered into for profit or not for profit, the status of the property at March 1, 1913, the effective date of the sixteenth amendment to the United States constitution (known as the income tax amendment) is decisive in making the determination, provided the property represented by the transaction was owned prior thereto."

V

The court erred in declining to make and rejecting plaintiffs requested conclusion of law numbered V, as follows:

"I find, as a conclusion of law, that plaintiff is entitled to a
46 judgment against the defendant in the amount sued for as set forth in the statement of claim, together with costs and statutory interest, subject, however, to adjustment and modification in the amount of $4,863.04, which has already been refunded to the plaintiff, and such further adjustment as results from revising or correcting the loss on the sale of the former residence from $47,000.00 to $46,293.21."

Wherefore the plaintiff prays that the judgment of the District Court may be reversed.

JAMES WALTON,
*Attorney for Plaintiff.*

PITTSBURGH, PENNA., *January 25, 1927.*

In United States District Court

*Stipulation re transcript of record*

And now, to wit, January 24th, 1927, it is hereby stipulated and agreed by and between counsel for plaintiff and counsel for the defendant that the following be printed as and constitute the record on writ of error in the above case before the United States Circuit Court of Appeals for the Third Circuit, viz:

1. Docket entries.
2. Statement of Claim.
3. Affidavit of defense.
4. Request for findings of fact and conclusions of law ex parte plaintiff.
5. Opinion of the court filed November 23, 1926.

47 6. Supplemental opinion of the court filed January 21, 1927, together with order of judgment in favor of the defendant which is a part thereof.

7. Assignments of error.
8. This stipulation.

JAMES WALTON,
*Attorney for Plaintiff.*
W. J. AIKEN,
*Asst. U. S. Attorney,*
*Attorney for Defendant.*

[Clerk's certificate to foregoing transcript omitted in printing.]

48 [Minute entry of argument and submission, March 8, 1927, omitted in printing.]

49 In United States Circuit Court of Appeals for the Third Circuit

No. 3594. March term, 1927

JAMES R. TINDLE AND THE UNION TRUST COMPANY OF PITTSBURGH, co-executors of the last will and testament of Philander C. Knox, deceased, plaintiffs below, plaintiffs in error

vs.

D. B. HEINER, COLLECTOR OF INTERNAL REVENUE, DEFENDANT BELOW, defendant in error

In error to the District Court of the United States for the Western District of Pennsylvania

Before Buffington, Woolley, and Davis, Circuit Judges

*Opinion filed April 4, 1927*

BUFFINGTON, circuit judge:

The case centres around the word "transaction"—"transaction entered into for profit"—as used in the revenue act of 1918 (40 Stat. c. 18, section 214, a 5) in respect to losses allowed as deductions in income tax returns. What, in point of fact, is the transaction we are here dealing with? Was it one Congress meant to cover by this section? Viewed as an entirety the transaction involved is this: In 1887–1888 the late Philander C. Knox bought ground in the city of Pittsburgh and built a residence thereon at a cost in all of $172,000. In 1920, he sold this property and residence for $73,706.79, so that taken as a whole, the transaction, begun in 1887 and ended in 1920, constitutes a single whole from the viewpoint of buying and selling, but when this single whose is considered from the standpoint of the use to which the property had, meanwhile, been put, it resolves itself into two distinct and wholly different transactions. First, the property was used by him as a residence; he built the house for that purpose and so used it until 1901. This transaction was therefore a distinctively home, residential, one. In 1901, however, he entered into national public life and gave up the property as a residence and never afterwards occupied it. He acquired a residence by living in a different ward of the city and retained it up to the time of his death for occasional residential and seasonal voting purposes,
50 and, as stated by counsel at the hearing, his regular winter residence was in Washington City, where he bought and occupied a home, and his summer residence in a home he owned at Valley Forge, Pennsylvania. With the ending of his occupation of his Pittsburgh home, he rented the same on long term leases. His first lease was in October, 1901, for three and a half years; later for

a term of ten years and thereafter for shorter terms, until the property was finally sold. With the giving up of his residence all sentimental connection in the use of the house as a home ended and thereafter the use of the property was by others under lease from him during the running of the first lease for three years, to wit from October 1, 1901, and then from April 1, 1905, for ten years. During the running of these leases he was of course unable to sell the property by reason of the use he was making of it and the leases he had given for his own profit. Such being the status of the transaction, the ordinary one of owning real estate for leasing purposes, the situation of the property under the second or ten year lease when the income tax law of 1913 was passed, was a distinctively non-residential and a distinctively business leasing of real estate for profit. We think we are justified in regarding the transaction here involved by its then and subsequent status. The situation was in no wise different than it would have been had he always owned and used the property for renting purposes and never for residential purposes, because the residential use had finally and forever ceased at the time of the passage of the income tax law. What then was the fact and status in money value of this property when the income tax law of 1913 was passed? It was a distinctively renting transaction and in this transaction was involved the use for renting of property of the agreed upon then value of $120,000. Any system of bookkeeping in this transaction would have had charged against it an investment of $120,000 represented by real estate and the rents upon the same would have been profits. What then would have been the result of this transaction when it was finally closed? Clearly instead of profits a loss represented by the shrinkage in value of the property during that time of $46,293.21.

But, assuming the situation was one where some might contend, as did the court below, that the language of Congress was intended to treat the transaction as a purchase and sale of property without reference to what its use was during the interim, it seems to us the opposite view might very reasonably be taken of holding Mr.
51 Knox's tenure as made up of two transactions, one, the residential one, which had ceased to exist long before and to which the law did not apply, the other, a purely business venture, unfortunate in its results, but one which the law fairly contemplated should be off-set against other items of income which the owner of the property sustained. It seems to us therefore with this double interpretation in the balance that the law would then resolve that uncertainty against the Government in favor of the taxpayer. Assured as we are that this latter transaction was one entered into and carried on for profit, the decedent in the assessment of his net income should have been allowed credit for the loss resulting therefrom.

The judgment below will therefore be reversed with instructions to enter judgment for the taxpayer's estate.

[File indorsement omitted.]

52 In United States Circuit Court of Appeals

[Title omitted.]

*Judgment filed April 4, 1927*

In error to the District Court of the United States, for the Western District of Pennsylvania.

This cause come on to be heard on the transcript of record from the District Court of the United States, for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be, and the same is hereby reversed, with instructions to the said District Court to enter a judgment in favor of the plaintiffs.

Philadelphia, April 4, 1927.

Per Curiam: BUFFINGTON, *Circuit Judge.*

[File endorsement omitted.]

53 In United States Circuit Court of Appeals

*Mandate filed May 9, 1927*

*The President of the United States of America,*
*To the honorable the judges of the District Court of the United States for the Western District of Pennsylvania, greeting:*

Whereas, lately in the District Court of the United States for the Western District of Pennsylvania, before you or some of you, in a cause between James R. Tindle and The Union Trust Company of Pittsburgh, coexecutors of the last will and testament of Philander C. Knox, deceased (plaintiffs below), plaintiffs in error; and D. B. Heiner, collector of United States internal revenue for the 23d district of Pennsylvania (defendant below), defendant in error, a judgment was entered in the said District Court on the twenty-first day of January, 1927, which judgment is of record in the office of the clerk of the said District Court, to which reference is hereby made, and the same is hereby expressly made a part hereof.

54 And whereas, in the present term of March, in the year of our Lord one thousand nine hundred and twenty-seven, the said cause came on to be heard before the said United States Circuit Court of Appeals on the said transcript of record and was argued by counsel:

On consideration whereof, it is now here ordered and adjudged by this court, that the judgment of the said District Court in this cause be, and the same is, hereby reversed, with instructions to the said District Court to enter a judgment in favor of the plaintiffs.

Philadelphia, April 4, 1927.

You, therefore, are hereby commanded that such execution and further proceeding be had in said cause, as according to right and

justice, and the laws of the United States, ought to be had, the said writ of error notwithstanding.

Witness, the Honorable William Howard Taft, Chief Justice of the Supreme Court of the United States, at Philadelphia, the ninth day of May, in the year of our Lord one thousand nine hundred and twenty-seven (1927).

SAUNDERS LEWIS, Jr.,
*Clerk of the U. S. Circuit Court of Appeals, Third Circuit.*

[File endorsement omitted.]

55 [Clerk's certificate to foregoing transcript omitted in printing.]

56 Supreme Court of the United States

*Order allowing certiorari, filed October 24, 1927*

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsed on cover:] File No. 32793. U. S. Circuit Court of Appeals, Third Circuit. Term No. 341. D. B. Heiner, collector of United States internal revenue for the twenty-third district of Pennsylvania, petitioner, *vs.* James R. Tindle and The Union Trust Company of Pittsburgh, coexecutors, etc., petition for writ of certiorari and exhibit thereto. Filed June 30th, 1927. File No. 32793.

○

Office Supreme C
FILE
JUN 30
CHARLES ELMORE

IN THE

# United States Circuit Court of Appeals

FOR THE THIRD CIRCUIT.

NO. 3594. 341

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, co-executors of the last will and testament of Philander C. Knox, Deceased, Plaintiffs Below, Plaintiffs-in-Error,

v.

D. B. HEINER, Collector of United States Internal Revenue for the 23rd District of Pennsylvania, Defendant Below, Defendant-in-Error.

## TRANSCRIPT OF RECORD.

Error to the District Court of the United States for the Western District of Pennsylvania, at No. 3432 Law.

JAMES WALTON,
1530 Park Building,
Pittsburgh, Pa.
Attorney for Plaintiff-in-Error.

JOHN D. MEYER,
United States Attorney,

W. J. AIKEN,
Assistant United States Attorney,
Attorneys for Defendant-in-Error.

SMITH BROS. CO. INC., LAW PRINTERS, 210-212 GRANT ST., PITTSBURGH, PA.

## Index to Record.


| | PAGE |
|---|---|
| Docket Entries | 1 |
| Statement of Claim | 3 |
| Exhibit A, Copy of Claim for Refund | 13 |
| Taxpayer's Statement of Reasons for Refund | 17 |
| Copy of Field Agent's Report | 19 |
| Affidavit of Defense | 25 |
| Opinion of Court | 29 |
| Plaintiff's Request for Findings of Fact and Conclusions of Law | 35 |
| Order of Court, Adopting Findings of Fact and Rejecting Conclusions of Law | 42 |
| Judgment | 43 |
| Assignments of Error | 44 |
| Stipulation for Printing Record | 46 |
| Certificate | 47 |

Resp. sued for $20,000 alleged overpayment of income tax for 1920. He found for Resp, but CCA reversed. Question is whether a loss may be claimed on the sale of real property, first used as residence and later leased. The CCA held it could. Depends on

24(a)(3) Rev Act of 1918 Wis p. 5 + this →

Carried into later acts.

In 1887 Philander Knox built dwelling house in Pittsburgh for $72,000. He occupied this until 1901 when it ceased to be his residence. Thereafter he leased it. In 1913, its value was $120,000. In 1920 he sold it for $73,000. In his income tax for that year, he claimed the dif. between $120,000 value in 1913 and $73,000 as a loss. He paid under protest a tax which disallowed this and his estate sued for $20,000

CCA said:

1. Two transactions - one beginning in 1887 and other in 1901. The last was for profit and continued until the sale. It came within the statute

2. If not two separate transactions - since it might be held the transaction beginning "In . . . " [illegible] — then two phases of the same action (I quote freely & seek understandingly to paraphrase what is not perfectly clear to me) and the last gave it the character of profit which extended down to 1920.

WJ says:

1. A transaction ending with a sale must have been begun with a profit purchase, since if [illegible] not having entered (begun) by for profit, it does not come within statute

2. If the lease in 1901 began a new transaction what was property worth when it was first leased. That is important because the rule of McCaughn v. Ludington, 768/106 is that the basis for gain or loss of dep. between selling price and cost or value in 1913, whichever is lower. No telling what value was in 1901

3. If lease in 1901 was beginning the termination of lease was sale. The sale had nothing to do with it

4. Such [illegible] has always been held without the statute. Congress was clear. This confuses the law.

## RECORD.

Among the Rolls, records and judicial proceedings had in the District Court of the United States for the Western District of Pennsylvania, at No. 3432 in Law, may be found the following words and figures:

IN THE DISTRICT COURT
OF THE UNITED STATES OF AMERICA
FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

JAMES R. TINDLE and THE UNION TRUST COMPANY OF PITTSBURGH, co-executors of the last will and testament of PHILANDER C. KNOX, deceased,
Plaintiffs,
v.
D. B. HEINER, Collector of United States Internal Revenue for the 23rd District of Pennsylvania,
Defendant.
} Law No. 3432.

### Docket Entries.

Jan. 22, 1926 Praecipe for summons in assumpsit and Statement of Claim filed.

Jan. 22, 1926 Summons in assumpsit issued returnable 1st Mon. of Feb. next.

Jan. 29, 1926 Summons returned served on D. B. Heiner, Collector of Internal Revenue, 23rd Dist. Pa. by handing to and leaving a true and attested copy

thereof with D. B. Heiner, personally at Pittsburgh, Jan. 23, 1926.

Feb. 2, 1926 Praecipe for appearance of John D. Meyer and W. J. Aiken for deft.

Feb. 25, 1926 Affidavit of Defense filed.

Mar. 10, 1926 Stipulation waiving Jury trial filed.

Mar. 10, 1926 Trial without a jury had; C. A. V.

Mar. 10, 1926 Witnesses sworn for Plff. (4)

Mar. 10, 1926 Motion of W. J. Aiken, for the court to render judgment for the defendant filed.

Mar. 10, 1926 Trial Mem. filed.

Nov. 23, 1926 Opinion entitling plaintiff to judgment in sum of $4,863.04 with interest from February 2, 1925 and judgment entered accordingly, filed and entered.

Jan. 21, 1927 Stipulation filed, agreeing that judgment of $4,863.04 hereinbefore entered in favor of plaintiff, be vacated.

Jan. 21, 1927 Order of Court filed and entered vacating the judgment entered on Nov. 23, 1926, and entering judgment in favor of the defendant with costs.

Jan. 21, 1927 Request for findings of fact and conclusions of law and the action of the court with reference thereto.

Jan. 25, 1927 Assignments of Error filed.

Jan. 25, 1927 Petition for Writ of Error filed.

Jan. 25, 1927 Order of Court filed and entered allowing Writ of Error and fixing the bond for costs at the sum of $200.

Jan. 25, 1927 Citation with acceptance of service by W. J. Aiken issued.

Jan. 25, 1927 Stipulation for printing record filed.

Jan. 25, 1927 Writ of error allowed.

Jan. 27, 1927 Bond on appeal approved & filed.

Certified from the records this 28th day of January, 1927.

J. WOOD CLARK,
*Clerk.*

[SEAL]

## Praecipe and Statement of Claim.

Filed January 22, 1926.

PRAECIPE.

To J. WOOD CLARK, *Clerk*:

Issue summons in assumpsit returnable next return day.

JAMES WALTON,
*Attorney for Plaintiffs.*

STATEMENT OF CLAIM.

James R. Tindle and The Union Trust Company of Pittsburgh, plaintiffs above named, bring this suit against D. B. Heiner, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania at Pittsburgh, to recover the sum of Twenty thousand three hundred fifty-six and 85/100 ($20,356.85) dollars, with interests and costs upon a cause of action whereof the following is a statement:

I.

Philander C. Knox died October 12th, 1921. At the time of his death he was a citizen of Pennsylvania and a resident of Pittsburgh, Allegheny County, in

the Western District of said state. His last will and testament was duly admitted to probate in the Orphans' Court of Allegheny County and, on October 21st, 1921, letters testamentary were duly granted to the plaintiffs, who thereupon duly qualified and entered upon the duties of their office. The plaintiff, James R. Tindle, is a citizen of the Commonwealth of Pennsylvania, residing at Valley Forge, Chester County, in said state, and the plaintiff, The Union Trust Company of Pittsburgh, is a Pennsylvania corporation, with its principal office and place of business at Pittsburgh, Allegheny County, Pennsylvania. By its articles of incorporation, The Union Trust Company of Pittsburgh is authorized and empowered to act as executor, trustee and in other fiduciary capacities.

II.

The defendant, D. B. Heiner, is a citizen of the Commonwealth of Pennsylvania and a resident of Kittanning, Armstrong County. Said Armstrong County is in the Western District of Pennsylvania. Said Heiner, at the time of the grievance herein complained of and at the date of filing the complaint, is Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, which district comprises within its borders the County of Allegheny.

III.

Within the time prescribed by law, the said Philander C. Knox, pursuant to the provisions of the Act of Congress approved February 24, 1919, entitled "An Act to provide revenue, to defray war expenses

and for other purposes" (commonly known as the Revenue Act of 1918), duly made and filed his income tax return for the calendar year 1920 on Form 1040, which is the form prescribed by the Treasury Department. Said income tax return showed a total tax liability of $2,991.68, which amount was duly paid to the defendant within the time prescribed by law.

IV.

In his said tax return taxpayer claimed as a deduction from income the sum of $47,000.00, representing a loss suffered on the sale of certain real property situate at 5044 Ellsworth Ave., Shadyside, Pittsburgh, Pa. Taxpayer computed such loss as follows:

| | | |
|---|---|---|
| March 1st, 1913, fair value, | | $120,000.00 |
| Depreciation sustained | $ 3,000.00 | |
| Selling Price | 70,000.00 | |
| | | 73,000.00 |
| Loss | | $ 47,000.00 |

Such loss was claimed as a deduction from taxable income by virtue and under authority of section 214, (a), 5, of the said Revenue Act of 1918, which reads:

> "That in computing net income there shall be allowed as deductions:—
>
> * * * * * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit though not connected with the trade or business."

V.

The facts with reference to the said transaction are that in the years 1887-1888 former United States Senator Philander C. Knox built a residence at 5044 Ellsworth Avenue, Shadyside, Pittsburgh, Pa. A short time later he built a stable. Both buildings were of the very highest type of construction.

The land itself was acquired in three transactions. In 1886 the greater part of the land was acquired for an indicated consideration of ten thousand ($10,000.00) dollars from D. Aiken, Jr. In 1887 an additional strip was acquired from Aiken for an indicated consideration of fourteen hundred ($1,400.00) dollars. In 1892 another strip was acquired from H. C. Frick for the nominal sum of one ($1.00) dollar. The actual consideration plaintiffs have been unable to establish, however, the United States Revenue Field Agent who examined this case reports on page 2 that the total cost of the land was $16,400.00, which is probably correct.

The cost of the buildings has been established by A. & S. Wilson Company, one of the oldest firms of contractors in Pittsburgh. They show a cost appraisal of the residence as of the date of construction in the aggregate amount of $119,458.00. Similarly, with respect to the stable, they show the reproductive cost as of the date of construction to be $10,226.00.

About the year 1901, the Senator having been elected to the United States Senate, he leased the entire property to Mr. W. E. Corey, former President of the United States Steel Corporation, for a period

of 3½ years, the lease being dated October 1st, 1901, and providing for an annual rental of eight thousand ($8,000.00) dollars. Upon the expiration of this lease a new lease was made on April 1st, 1905, having a duration of ten years and providing for an annual rental of sixty-five hundred ($6,500.00) dollars. This lease was followed by a third lease dated April 1st, 1915, having a duration of one year for a stated annual rental of six thousand ($6,000.00) dollars.

Other leases followed these, for the property was tenanted by various parties from time to time down to November 13th, 1920, when the property was sold to Mr. James H. Hammett.

At no time after the leasing of the property to said W. E. Corey in 1901 was it occupied by the Senator or by his family or by any of his relatives. He forthwith established an actual and legal residence at a place elsewhere in Pittsburgh, and this place, at the date of the sale on November 13, 1920, was the Schenley Hotel, Forbes Street, from which residence he voted. In addition to the Schenley Hotel legal residence, the Senator maintained temporary residences in Washington, D. C., and Valley Forge, Chester County, both of which he owned in fee.

As a part of the transaction Hammett was required to turn over to the Senator the equivalent of $9,500.00 advance rental collected by him on a garage property, which garage property represented part consideration in the transaction. The Field Agent held that such sum constituted additional income to the Senator and made adjustment accordingly (page 3 of his report).

The Field Agent made a computation of his own

of the consideration received by the Senator, taking into consideration accrued taxes, interest, etc., and arrived at the amount of $64,206.79 (page 3 of his report). For the purpose of this suit, it is admitted that the consideration as found by the Field Agent is correct, provided that there be added thereto the $9,500.00 hereabove mentioned.

VI.

Thereafter, as the result of the examination of plaintiffs' tax liability by the said United States Field Agent J. B. Harmon, plaintiffs were advised of a proposal to assess an alleged additional tax in the sum of $19,659.73. The said Field Agent, as pretended justification for the imposition of the proposed additional tax, asserted that taxable income shall be increased $56,500.00. In his official report, of which plaintiffs have been given a copy, he makes the following explanation—

> "In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92 be increased by the following:—
>
> | | | |
> |---|---|---|
> | Disallowance of loss on sale of former residence | $47,000.00 | |
> | Rent for the year 1921 received in 1920 | 9,500.00 | |
> | | | 56,500.00 |
> | Corrected Net Income | | $94,156.92" |

VII.

Thereafter, under date of September 27th, 1924, symbols IT:PA-5, CTN-505, the Commissioner of Internal Revenue advised plaintiffs that the conclusions of the Field Agent had been confirmed and that there was due from plaintiffs a pretended deficiency in tax of the aforesaid sum of $19,659.73.

VIII.

Thereafter, on or about January 23rd, 1925, the defendant, as Collector of United States Internal Revenue, demanded payment of the said sum of $19,659.73 alleged additional income tax from plaintiffs. Said amount was paid by plaintiffs to defendant on February 2nd, 1925, and such payment was made under protest and under duress, such duress consisting of threats by said defendant Heiner to impose penalties, levy distraint and seize plaintiffs' property.

IX.

Thereafter, on June 1st, 1925, plaintiffs duly filed with the defendant as Collector of Internal Revenue for the Twenty-third Pennsylvania District at Pittsburgh, on Form 843, the form prescribed by the Treasury Department, a claim for refund of the said amount of $19,659.73. A copy of said claim is attached hereto, designated Exhibit "A". There is imprinted thereon these words, as follows—

"Important.—File with the Collector of Internal Revenue where assessment was made."

X.

The said claim for refund was rejected by the Commissioner of Internal Revenue on August 20th, 1925, for the alleged reason that the loss claimed arose in a transaction not entered into for profit. At the time of filing this complaint, the said sum of $19,659.73 has not been refunded nor has any part thereof.

XI.

Plaintiff avers that there existed no warrant in fact or in law for the disallowance and exclusion by the aforesaid taxing authorities of said $47,000.00 loss suffered on the sale of said property as a deduction in the computation of taxable income, upon the alleged theory that loss arose from a transaction not entered into for profit,—

(2), nor for the imposition and collection of $19,659.73 alleged additional tax as a consequence thereof—

(3), nor for assuming that the selling price of the property was less than its cost; when, as a matter of truth and fact, the cost of the property was not less than $172,401.00—

(4), nor for assuming that the fair market value of the property at March 1st, 1913, was not in excess of $65,000.00; when, as a matter of truth and fact, the fair market value of the property at said date was not less than $125,000.00—

(5), nor for assuming that $9,500.00 received by taxpayer was taxable income because taxpayer's grantee had collected a like amount as advance rental

when, as a matter of truth and fact, such sum was part of the consideration received for the sale.

XII.

Plaintiffs further aver that the amount of loss correctly and properly deductible in the computation of the tax liability is—

| | | |
|---|---|---|
| Fair market value of property at March 1st, 1913 | | $125,000.00 |
| Consideration received:— | | |
| As computed by Field Agent | $64,206.79 | |
| Additional consideration | 9,500.00 | |
| | | 73,706.79 |
| Deductible Loss | | $ 51,293.21 |

XIII.

When the true and correct amount of the deductible loss from the aforesaid sale, to wit, the said sum of $51,293.21, is employed, the amount of tax properly refundable is shown to be $20,356.85, all of which is set forth in the following computation:—

| | | |
|---|---|---|
| Taxable income employed by Field Agent and adopted by Commissioner | | $94,156.92 |
| Amount of loss deductible | $51,293.21 | |
| Amount erroneously added to income as rent | 9,500.00 | |
| | | 60,793.21 |
| Correct taxable income | | $33,363.71 |

| | | |
|---|---|---|
| Tax previously paid: | | |
| Paragraph III, *supra* | $ 2,991.68 | |
| Paragraph VIII, *supra* | 19,659.73 | |
| | | $22,651.41 |
| Tax on $33,363.71 | | 2,394.56 |
| Amount refundable | | $20,356.85 |

XIV.

Under sections 1019 and 1020 of the Revenue Act of 1924, plaintiffs may be allowed interest at the rate of six per centum per annum on the said sum of $20,356.85, from the date of payment thereof, to wit, from February 2nd, 1925.

XV.

This is a suit of a civil nature at common law and the matter in controversy, exclusive of interest, exceeds the sum of $3,000.00. The cause of action herein set forth arises under the laws of the United States for the assessment and collection of internal revenue.

WHEREFORE, plaintiffs pray judgment of the defendant in the sum of Twenty thousand, three hundred fifty-six and 85/100 ($20,356.85) dollars with interest, together with the costs of this suit.

JAMES WALTON,
*Attorney for Plaintiffs.*

*Commonwealth of Pennsylvania,*
*County of Allegheny.* } ss:

I, Charles E. Young, being first duly sworn, depose and say that I am Assistant Trust Officer of The Union Trust Company of Pittsburgh, co-executor of the Estate of Philander C. Knox, and that the allegations in the foregoing statement of claim are true and correct, as I verily believe.

CHARLES E. YOUNG.

Subscribed and sworn to before me this 22nd day of January, A. D. 1926.

LILLIAN D. MCCULLOUGH,

[SEAL] *Notary Public for Pennsylvania.*

My commission expires Feb. 26, 1927.

James R. Tindle et al. v D. B. Heiner, Collector.

EXHIBIT A—

Copy of Claim for Refund.

(Execute separate form for each tax period).

Claim for

Refund of Taxes Illegally Collected.

*State of Pennsylvania,*
*County of Allegheny.* } ss:

ESTATE OF PHILANDER C. KNOX, Deceased

c/o Union Trust Company, Executor

Pittsburgh, Pa.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below

with reference to said statement are true and complete:

1. Business in which engaged. Individual.

2. Character of assessment or tax. 1920 Income.

3. Amount of assessment or stamps purchased (alleged additional) $19,659.73.

4. Reduction of Tax Liability requested (Income and Profits Tax). Not applicable.

5. Amount to be abated. Not applicable.

6. Amount to be refunded (or such greater amount as is legally refundable) $19,659.73.

7. Dates of payment (see Collector's receipts or indorsements of canceled checks). February 2nd, 1925.

8. District in which return (if any) was filed. 23rd Penna., Pittsburgh.

9. District in which unpaid assessment appears. Not applicable.

10. Amount of overpayment claimed as credit. Not applicable.

11. Unpaid assessment against which credit is asked; period from. Not applicable.

Deponent verily believes that this application should be allowed for the following reasons:

Taxpayer attaches hereto a full and complete statement of the reasons why refund in the above stated amount should be made. Such statement, together with the exhibits attached thereto are hereby referred

to and specifically made a part of this claim for refund.

Address of taxpayer's attorney:

JAMES WALTON,
Southern Building,
Washington, D. C.

THE UNION TRUST COMPANY OF PITTSBURGH

By (Signed) CHARLES E. YOUNG,
*Co-Executor*
*Asst. Trust Officer.*

Sworn to and subscribed before me this 1st day of June, 1925.

(Signed) JESSIE A. ROBERTSON,
*Notary Public.*

| | |
|---|---|
| In the matter of PHILANDER C. KNOX, Deceased UNION TRUST COMPANY, Executor Pittsburgh, Penna. 1920 Income Tax | Taxpayer's statement of the reasons why refund must be made. |

I.

A report of examination by Field Agent J. B. Harmon of the Pittsburgh Revenue office, a copy of which was delivered to the executor on January 21st, 1924, advises taxpayer of a proposal to assess him with an additional tax in the amount of $19,659.73. A copy of this field agent's report is attached hereto as Exhibit A and the essential part thereof with reference to this particular matter reads as follows:

"In view of the fact that the selling price

of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92, be increased by the following:

| | | |
|---|---|---|
| Disallowance of loss on sale of former residence, | $47,000.00 | |
| Rent for the year 1921 received in 1920 | 9,500.00 | 56,500.00 |
| Corrected Net Income, | | $94,156.92" |

II.

Thereafter the Commissioner of Internal Revenue at Washington, D. C., under date of July 24th, 1924, symbols IT:PA:5 CTN-505, duly advised the taxpayer of a proposal to assess an alleged deficiency in tax amounting to $19,659.73. This letter was on the usual Form NP-1, and the essential part of it reads:

| | "Additional Tax |
|---|---|
| 1920 | $19,659.73 |

Verification of the books of account and records of Philander C. Knox as shown by the supplemental report of the revenue agent dated March 29, 1924, has been approved.

You are advised that the action taken by the revenue agent in regard to the disallowance of the loss on the sale of his residence has been sustained."

III.

Thereafter, on or about January 23rd, 1925, the Collector of Internal Revenue at Pittsburgh, Pa., made due demand for the payment of the aforesaid sum of $19,659.73, which amount was paid by the executor of the deceased taxpayer on February 2nd, 1925, all of which appears from the collector's receipt, a copy of which reads:

RECEIPT FOR PAYMENT OF TAXES
ORIGINAL
Addl. Income Tax

Collector's Office 23rd District of Penna.
at Pittsburgh, Pa.
Date 2/2/25 CHECK Year 1920

NAME AND ADDRESS OF TAXPAYER
Philander C. Knox, Deceased
c/o Union Trust Co., Executor
Pittsburgh, Pa.

Amount $19,659.73
1924 Addl. Jan. 186 P

PAID
Feb. 2 1925
INT. REV. COL. OFFICE
23rd District, Pgh., Pa.

IV.

Taxpayer respectfully shows that the Field Agent erred, that the Commissioner's office erred in adopting the conclusions of the Field Agent and that the action of the Collector of Internal Revenue at Pittsburgh, in insisting upon the payment of the alleged

additional tax was incorrect, not in accordance with the facts and contrary to law, in the following particulars:

(1), in assuming that the selling price of the property was less than its cost; whereas, as a matter of truth and fact, the cost of the property, the loss upon the sale of which is proposed to be disallowed, was not less than $124,206.79.

(2), in assuming that the market price of the property at March 1st, 1913, was not in excess of $65,000.00; whereas, as a matter of truth and fact, the market value of the property at said date was not less than $120,000.00.

(3), in presuming to add and include as taxable income an amount of $9,500.00 paid to the taxpayer by the purchaser of the property, which $9,500.00 represented advance rent collected by said purchaser on property which he traded to the taxpayer as part consideration for the taxpayer's property. As a matter of fact and law, this $9,500.00 was income of the taxpayer's grantee when received by him and is not, in any sense, taxable income to your petitioner; notwithstanding all of which, the Field Agent has so computed it and his computation has been tentatively approved by the office of the Commissioner of Internal Revenue.

It thus appearing that the Field Agent's proposed increase of taxable income is erroneous, it necessarily follows that the alleged additional income tax required to be paid thereon was not lawfully due and that the amount thereof should be refunded.

EXHIBIT A.

Copy of Field Agent's report
Dated January 18, 1924.

In the matter of
Philander C. Knox, Deceased,
Union Trust Company, Executor,
Pittsburgh, Penna.
1920 Income Tax

* * * * * * * *

"Note: If conference is desired, please arrange for an appointment. Mail to 802 Chamber of Commerce Bldg. Phone Smithfield 2438.

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

OFFICE OF
INTERNAL REVENUE AGENT
IN CHARGE
Pittsburgh Division.

January 18, 1924.

In re: P. C. Knox,
c/o Union Trust Company—Executor,
Pittsburgh, Pa.
Date of Report: January 11, 1924.
Year Examined: 1920.

Sirs:

There is transmitted herewith copy of report covering examination recently made by a representative of this office concerning your income tax liability.

No remittance should be made until you receive notice of assessment from the Collector of Internal Revenue for your district.

It is desired that every opportunity be afforded you to present any objections or any additional information which you believe might affect the result of the final decision of the Commissioner of Internal Revenue at Washington, D. C. The original of this report will therefore be held in this office for a period not to exceed twenty days from the date of this letter in order that you may, if you so desire, present any protests, briefs, or letters should be forwarded in duplicate to this office. These papers will receive consideration before the report with all papers pertaining to the same is transmitted to Washington for final action by the Commissioner of Internal Revenue. If you agree to the findings of the examining officer, the report will be forwarded to the Department at once.

Please acknowledge receipt by return mail, indicating whether protest will be submitted.

Respectfully,

ALBERT W. SMITH,
*Internal Revenue Agent in Charge.*

In re: P. C. Knox,
c/o Union Trust Company, Executor,
Pittsburgh, Pa.

January 11, 1924.

| Examining Officer | Examination Commenced | Examination Completed |
|---|---|---|
| J. B. Harmon. | December 20—Suspended | January 11—7½ days |

Internal Revenue Agent in Charge,
Pittsburgh, Pa.

An investigation of records in connection with

the income tax liability of the above named individual for the calendar year 1920 discloses the following:

Summary

| Year | Form | Additional Tax |
|---|---|---|
| 1920 | 1040 | $19,659.73 |

Authority for Examination—Photostat copy of 1920 return, which is attached hereto.

Lack of records in this district prevented a thorough examination, although it is extremely doubtful that sufficient records could be assembled for such an examination of this case.

Your examiner has delved into all the available records in this city and has made quite a thorough examination of the sale of taxpayer's former residence reported in his 1920 return.

Marital Exemption—Married, living with wife.

Wife's Income—Separate return, with no claim for exemption.

The valuation placed by the City of Pittsburgh on the former residence property of the taxpayer for the year 1913 and subsequent years, including the year 1920, was as follows:

| | |
|---|---|
| Land | $ 72,630.00 |
| 2 story stone brick dwelling | 40,000.00 |
| Frame stable | 3,000.00 |
| Total | $115,630.00 |

Your examiner finds upon investigation that the land included in the above cost the taxpayer $16,400.00 in three lots bought in 1886, 1887 and 1892. The cost

to the taxpayer for the erection of the buildings was probably $50,000.00 or more.

The real estate agent who sold the taxpayer's former residence property stated that the price at which it was sold, $65,000.00, was the market value of the property at March 1, 1913, and that a greater price could not be obtained for it at that date. The distribution of value at March 1, 1913, would probably be land, $40,000.00; dwelling, $24,000.00, and stable, $1,000.00.

In the sale of his property, the taxpayer took in payment a $90,000.00 property and assumed a mortgage of $40,000.00 on same, leaving him an equity of $50,000.00, which is confirmed by $50.00 of Revenue Stamps on deed received, and in addition, he received $15,000.00 cash. The former owner of the $90,000.00 property had received $9,500.00 in advance for rent of the large garage building on his property for the year 1921. This rent he had to turn over to the taxpayer at the time of closing the sale in November of 1920. The taxpayer apparently thought he had included this advance rent in the reported selling price of his property at $70,000.00, but investigation of the records of the real estate agent who sold the property for him discloses the fact that he received the following in settlement for the sale:

| | |
|---|---|
| Equity in new property | $50,000.00 |
| Cash | 15,000.00 |
| Accrued Interest on $40,000.00 Mortgage from 6/12/20 to 11/15/20 | 1,020.00 |

| | | |
|---|---|---|
| Pro rata amount of 1920 city and county taxes on his former residence property | 404.40 | |
| | | $66,424.40 |
| Less pro rata amount of 1920 city and county taxes on property taken in payment | 152.61 | |
| Revenue Stamps on Deed given | 65.00 | |
| Commission for selling | 2,000.00 | |
| | | 2,217.61 |
| Net Proceeds or Selling Price | | $64,206.79 |

Depreciation from March 1, 1913 to Dec. 31, 1919, is as follows:

| | | |
|---|---|---|
| Brick Stone Dwelling— | | |
| $24,000.00 at 2% equals | 480.00 | per yr. |
| Frame Stable— | | |
| 1,000.00 at 5% equals | 50.00 | per yr. |
| Total | 530.00 | per yr. |

$530.00 per year for 6 5/6 yrs. equals $3,621.67.

In view of the fact that the selling price of this property was less than its cost but more than its fair market value at March 1, 1913, when depreciation is taken into consideration, it is recommended that there is no taxable gain or deductible loss from this transaction, and that the net income as shown by taxpayer's 1920 return, $37,656.92 be increased by the following:

| | | |
|---|---|---|
| Disallowance of loss on sale of former residence | 47,000.00 | |
| Rent for year 1921 received in 1920 | 9,500.00 | |
| | | 56,500.00 |
| Corrected Net Income | | 94,156.92 |
| Dividends | 66,544.00 | |
| Personal Exemption | 2,000.00 | |
| | | 68,544.00 |
| Amount subject to Normal Tax | | 25,612.92 |
| Amount subject to Normal Tax of 4% | | 4,000.00 |
| Amount subject to Normal Tax of 8% | | 21,612 92 |
| Normal Tax at 4% | 160.00 | |
| Normal Tax at 8% | 1,729.03 | |
| Surtax per Schedule | 20,762.18 | |
| Total Tax | 22,651.21 | |
| Previously Assessed | 2,991.48 | |
| Additional Tax | 19,659.73 | |

The Union Trust Co. of Pittsburgh, Pa., one of the executors of the now deceased taxpayer, has been advised of the findings of this examination and has protected it in a letter to be mailed in to this office.

(Signed) J. B. HARMON,
*Internal Revenue Inspector.*

*To the within Defendant*:

You are required to file an affidavit of defense to this statement of claim within 15 days from the service hereof.

JAMES WALTON,
*Attorney for Plaintiffs,*
Fulton Building,
Pittsburgh, Penna.

---

## Affidavit of Defense.

Filed February 25, 1926.

*State of Pennsylvania,* }
*County of Allegheny.* } *ss:*

D. B. Heiner, being duly sworn according to law, declares and says that he is the defendant in the above entitled cause and that he has a just, true, complete and legal defense to the whole of plaintiff's claim of the character and nature as follows:

1. The averments of paragraph 1 of plaintiffs' statement of claim are admitted.

2. The averments of paragraph 2 of plaintiffs' statement of claim are admitted.

3. The averments of paragraph 3 of plaintiffs' statement of claim are admitted.

4. The averments of paragraph 4 of plaintiffs' statement of claim are admitted.

5. The averments of paragraph 5 of plaintiffs' statement of claim are admitted.

6. The averments of paragraph 6 of plaintiffs' statement of claim are admitted.

7. The averments of paragraph 7 of plaintiffs' statement of claim are admitted.

8. The averments of paragraph 8 of plaintiffs' statement of claim are admitted.

9. The averments of paragraph 9 of plaintiffs' statement of claim are admitted.

10. The averments of paragraph 10 of plaintiffs' statement of claim are admitted but in mitigation thereof the defendant avers that on or about January 25, 1926, the said claim for refund was allowed in the sum of $4,863.04 and that the plaintiff, the Union Trust Company of Pittsburgh, Executor, etc., was notified of such allowance by letter from C. R. Nash, Assistant to the Commissioner, dated January 25, 1926, of which a copy was sent to Mr. J. M. Cumming, Southern Building, Washington, D. C., of counsel for the plaintiffs and so expects to be able to prove at the trial of this case.

11. The averments of paragraph 11 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the Revenue Act of 1918 there was no deductible loss suffered on the sale of said property; (2) that the said law justified the imposition and collection of the tax of $19,659.73, less the overassessment of $4,863.04, as above set out; (3) that there has been no assumption that the selling price of the property was not less than its cost; (4) that the fair market value of its property on March 1, 1913, in the claim for refund filed by the plaintiffs is stated at not less than $120,000, while in the complaint herein filed the same value of this property is stated at not less than $125,000; (5) that the contention of

the taxpayer in regard to the $9,500 has been conceded and this amount is the principal basis of the refund of $4,863.04 as above set out, all of which defendant expects to be able to prove at the trial of this case.

12. The averments of paragraph 12 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the Revenue Act of 1918 and regulations promulgated pursuant to law, no loss was suffered from the sale of this property, and so expects to be able to prove at the trial of this case.

13. The averments of paragraph 13 of plaintiffs' statement of claim are denied and in answer thereto defendant avers that under the provisions of the Revenue Act of 1918 and regulations promulgated in pursuance to law, there was no deductible loss for income tax purposes from the sale of this property, and that the only sum refundable to the plaintiffs herein is the sum of $4,863.04, which was made the subject of Certificate of Overassessment No. 877468 and of which plaintiffs were advised on January 25, 1926, the said amount being arrived at as follows:

| | |
|---|---|
| Tax assessed (original tax) | $ 2,991.68 |
| Additional assessment, January 1925 list, page 13, line 6 | 19,659.73 |
| Total assessment | $22,651.41 |
| Tax liability | 17,788.37 |
| Overassessment | $ 4,863.04 |

and so expects to be able to prove at the trial of this case.

14. The averments of paragraph 14 of plaintiffs' statement of claim are denied insofar as it is alleged that interest may be allowed at the rate of 6% per annum on said sum of $20,356.85, and in answer thereto the defendant avers that the plaintiffs are entitled to interest at the rate of 6% per annum upon any amount recovered in this action, but that the amount so recovered, if any, cannot exceed the sum of $19,659.73, less $4,863.04 heretofore allowed plaintiff as above set out, that is, $14,796.69, and so expects to be able to prove at the trial of this case.

15. The averments of paragraph 15 of plaintiffs' statement of claim are admitted.

I, therefore, owe the plaintiff nothing.

All of the above stated facts are correct and true and defendant avers and expects on the trial of this case to be able to prove the same.

D. B. HEINER.

Subscribed and sworn to before me this 24th day of February, 1926.

GERTRUDE HORTON BERGER,

[SEAL] *Dep. Clerk U. S. Dist. Court.*